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[redacted]

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This memorandum is in response to a request by Darryl K. Wong, of the San Francisco Appeals Office, for informal assistance about an export trade corporation issue relating to [redacted]. Mr. Wong has informed us that he has transferred this case to you.

FACTS:

[redacted], a domestic corporation, owns all of the outstanding stock of [redacted], a Swiss corporation, which owns all of the outstanding stock of [redacted]. [redacted] was incorporated in [redacted] on [redacted]. [redacted] reported its income on the basis of a fiscal year ending May 31st.

[redacted] was an export trade corporation (ETC), within the meaning of section 971(a) of the Internal Revenue Code prior to and throughout the year ended [redacted] Limited made a timely election under section 805(c) of the Deficit Reduction Act of 1984 (1984 Act), P.L. 98-36, not to be treated as an ETC with respect to taxable years beginning after [redacted]. During the fiscal year ended [redacted] but after [redacted], [redacted] made a dividend distribution to [redacted] in the amount of $[redacted]. [redacted]'s working capital and fixed assets decreased from $[redacted], at the end of the [redacted] taxable year, to $[redacted], at the end of the [redacted] taxable year.

ISSUE:

If an ETC that uses a fiscal year has elected to discontinue operations as an ETC, pursuant to section 805(c) of the 1984 Act, and during its last taxable year beginning before January 1, 1985, but after December 31, 1984, it distributes earnings attributable to previously excluded export trade income, will the earnings distributed be treated as previously taxed income pursuant to section 805(c) of the 1984 Act and section 1.921-1T of the Temporary Income Tax Regulations?

LAW & ANALYSIS:

Section 970(a) of the Code provides that for any year, the subpart F income of a controlled foreign corporation (CFC) that is an export trade corporation shall be reduced by an amount equal to so much of the export trade income for the year that constitutes foreign base company income, subject to the limitations of section 970(a)(1)(A) and (B).

Section 970(b) of the Code provides that each U.S. shareholder of a CFC which for any prior year was an export trade corporation shall include in gross income under section 951(a)(1)(A)(ii), as an amount to which section 955 applies, his pro rata share of the amount of decrease in investments in export trade assets of the CFC, subject to the limitations of section 970(b)(1) and (2).

Section 971(c) of the Code defines the term "export trade asset" to include working capital reasonably necessary for the production of export trade income and facilities located outside the United States for the storage, handling, transportation, packaging or servicing of export property.

Section 805(c)(1)(B) of the 1984 Act provides that if, before January 1, 1985, any ETC elects not to be treated as an ETC with respect to taxable years beginning after December 31, 1984, rules similar to the rules of paragraphs (2) and (4) of subsection (b) shall apply to such ETC.

Section 805(b)(2) of the 1984 Act provides that for purposes of applying the Internal Revenue Code of 1954 with respect to actual distributions made after December 31, 1984, by a DISC or former DISC which was a DISC on December 31, 1984, any accumulated DISC income of a DISC or former DISC which is derived before January 1, 1985 shall be treated as previously taxed income (within the meaning of section 996(f)(2) of such Code) with respect to which there had previously been a deemed distribution to which section 996(e)(1) applied.

Section 805(b)(1) of the 1984 Act provides that for purposes of applying the Internal Revenue Code of 1954, the taxable year of each DISC which (but for this paragraph) would include January 1, 1985 shall close on December 31, 1984.

Section 1.921-1T(c), Answer 1, of the Temporary Income Tax Regulations, provides that a corporation that qualifies as an ETC with respect to its last taxable year beginning before January 1, 1985 and elects to discontinue operations as an ETC for all taxable years beginning after December 31, 1984, shall not be required to take into income earnings attributable to previously excluded export trade income derived with respect to taxable years beginning before January 1, 1985. However, any amounts distributed by the former ETC (i.e., a corporation that was an ETC for its last taxable year beginning before January 1, 1985) shall be treated as being made out of current earnings and profits and then out of previously taxed income.

Section 805 of the 1984 Act terminates the taxable year of a DISC on December 31, 1984, but it does not do so for an ETC. Instead, under section 805(c) of the 1984 Act, an election not to be treated as an ETC will become effective as of the taxable year <u>beginning after</u> December 31, 1984. Section 1.921-1T(c) of the temporary regulations also provides that an ETC may elect to discontinue operations as an ETC for all taxable years <u>beginning after</u> December 31, 1984. Accordingly, the rules of sections 805(c)(1) and 805(b)(2) of the 1984 Act, under which previously excluded export trade income will be treated as previously taxed income, are effective for taxable years of the ETC beginning after December 31, 1984, rather than after December 31, 1984, as in the case of a DISC.

[redacted]'s election to discontinue operations as an ETC became effective as of the taxable year beginning [redacted], which is its first taxable year beginning after December 31, 1984. Prior to that date, [redacted] was an ETC and the normal rules of sections 970 and 971 of the Code apply. Accordingly, if the decrease in [redacted]s working capital and facilities resulted in a decrease in its investments in export trade assets for its fiscal year ended [redacted], [redacted], the U.S. shareholder, will include in gross income its pro rata share of such amount under section 951(a)(1)(A)(ii), to the extent provided in section 970(b). The earnings and profits attributable to the $[redacted] distributed to [redacted] during the taxable year ended [redacted], will be excluded from [redacted]'s gross income under section 959(b) to the extent [redacted] included these earnings and profits in gross income under section 951(a).

CONCLUSION:

The provisions of section 805(c)(1)(B) of the 1984 Act and section 1.921-1T(c) of the temporary regulations apply to taxable years of the ETC beginning after December 31, 1984. Sections 970 and 971 of the Code will apply to the taxable year of the ETC beginning before December 31, 1984. Accordingly, if [redacted] decreased its investments in export trade assets during the taxable year ended [redacted] must include in gross income, under section 951(a), its pro rata share of the amount of [redacted]'s decrease in investments in export trade assets, as provided under section 970(b). Further, the earnings and profits [redacted] distributed to [redacted] during [redacted]'s taxable year ended [redacted] shall not be treated as previously taxed except to the extent these earnings and profits are attributable to amounts included in [redacted]'s gross income under section 951(a).

If you have any questions about this memorandum, please call Valerie Mark at FTS 566-6645.